AMMA T-1

RECEIVED
DEC 30 11 34 AM '97
POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268

Postal Rate and Fee Changes, 1997)

Docket No. R97-1

Direct Testimony
of
JOSEPH E. SCHICK

On Behalf Of

ADVERTISING MAIL MARKETING ASSOCIATION

Communications with respect to this document may be sent to:

Ian D. Volner, Esquire
N. Frank Wiggins, Esq.
Venable, Baetjer, Howard & Civiletti, L.L.P.
1201 New York Avenue, N.W.
Suite 1000
Washington, D.C. 20005

Due Date: December 30, 1997

TESTIMONY OF JOSEPH E. SCHICK

Purpose

My name is Joseph E. Schick. I submit this testimony in support of the proposal advanced by the Advertising Mail Marketing Association ("AMMA") concerning the BMC and SCF drop entry discounts for Standard (A) mail. The purpose of my testimony is to show why, in the real world, a readjustment that closely approximates the existing differential between the SCF drop entry discount and the BMC drop entry discount will not only serve the interests of mailers, but also of the Postal Service and all users of the postal system. In separate testimony of its economic consultant, the AMMA has shown how the readjustment of these two discounts should be carried out and why, as a matter of economic theory, this readjustment is proper.

Autobiographical Sketch

I am the Manager of Postal Affairs at Quad/Graphics, Inc. headquartered in West Allis, Wisconsin. Quad is one of the largest printing and distribution companies for magazines, books, and parcels and for catalogs and other direct mail marketing materials. I have over 12 years of experience in postal affairs, and have been employed in my present position since 1990. I have served on numerous Mailer Technical Advisory Committee and informal industry working groups. I am presently Industry Vice-Chair of MTAC.

Why the BMC/SCF Discount Differential is Important in the Real World

Simply put, the differential in the discounts offered for BMC and SCF drop entry strongly influences the decision whether it is worthwhile for mailers to drop enter at destination SCFs, or whether they should simply enter their mailings at the BMC. The "BMC/SCF discount differential" is the difference between the BMC destination entry and the SCF entry discount. For example, at current rates, Standard (A) automation letters presorted to the three digit level and drop entered at a destination BMC pays 16.2 cents per piece, whereas the same mail drop entered at a destination SCF pays a rate of 15.7 cents per piece. Thus, the BMC/SCF differential is .5 cents at current rates. This .5 cent differential between the BMC and SCF discounts is preserved throughout the rate schedule for both Regular and ECR Standard (A) mail.

The rates proposed in this case, however, result in a change in the BMC/SCF differential. Using the same example as before, the proposed rate for automation letters sorted to the three digit level and entered at a destination BMC is 16.3 cents per piece, whereas the same mail entered at a destination SCF is 16.0 cents. Thus, under the proposed rates, the BMC/SCF discount differential would decrease from .5 to .3 cents, and this differential, too, is preserved throughout the schedule.

On its face, the change in the differential between the two discounts may seem small, only 2/10 of a cent. However, in the real world, direct mail marketers and mail service providers measure costs and cost savings on the total size of a mailing. The adjustment from a .5 to a .3 cent differential translates to $2 per thousand. Thus, on a moderately sized mailing of one million pieces, the savings that a mailer could realize by entering its mail at a destination SCF rather than entering the same mailing at a BMC is reduced, under the proposed rates, by $2,000, per mailing. The change in the BMC/SCF drop entry discount differential proposed here is significant in dollar terms.

That change will influence the behavior of direct mail marketers. The Rate Commission, understandably, and the Postal Service (somewhat less understandably) tend to think of price signals that influence the behavior of mailers only in terms of postage rates. However, to mail service providers and their direct marketing clients, it is the total cost of the job that counts. The total of the job includes not just postage but also the cost of preparing and, in the case of drop entry, transporting the mail to qualify for a particular discount. Drop entry at a destination SCF is more complex both in terms of basic transportation costs (including labor, stop-off charges and the like) and logistics (including scheduling and coordination of arrivals with SCF managers) than drop entry at a destination BMC. As a result, as a general proposition, it is more costly to drop enter at a destination SCF than the corresponding destination BMC.

At each step in the mail preparation process, mailers have a range of choices. The decision whether to drop enter mail at a destination SCF rather than the corresponding BMC is significantly determined by the extent to which the additional transportation cost is offset by a lower postal bill. Plainly, mailers that find it economically attractive to drop enter at destination SCF facilities will generally also accomplish an economic advantage at BMCs because the cost of transportation of the mail to the BMC is, in general, less than the cost of transportation to the destination SCF.

Thus, drop entry mailers must -- every time postage rates change -- ask themselves the following question: Is it still worthwhile, in terms of reduced postage, to bear the additional cost of transporting mail to destination SCFs? The change in the

BMC/SCF discount differential resulting from the rates proposed by the Postal Service will have an impact on the answer to that question: under the proposed rates, it is simply worth less -- by $2.00 per thousand -- to drop enter at a SCF than it is at current rates.[1]

Some mailers will, unquestionably, decide that SCF destination entry is no longer worth it and will shift their entry points to the destination BMC. Other mailers, faced with an overall increase in postage cost and a reduced incentive to drop enter to the destination SCF, will nonetheless continue to drop enter principally for the non-monetary reasons I describe below. But, neither these mailers nor the printing and distribution companies that serve them can afford to simply ignore the price signal that the Postal Service's drop entry discounts sends. Because the proposed rates will provide mailers a comparatively smaller (in relation to BMC entry) incentive to drop enter at the SCF, many will seek other means of offsetting the additional costs of doing so. The two most obvious means are to either to reduce the volume of their mailings or mail less frequently.

---

1 Of course, the actual calculations are done much more precisely than I have described here. In most cases the information for each job is entered into computers to calculate the cost and savings for each destination BMC and destination SCF to which the mailing could be sent. Nonetheless, the basic choice of whether it is worth it, in dollar terms, to drop enter at a destination SCF rather than the corresponding destination BMC is driven by the discount differential.

Why Readjustment of the BMC/SCF Discount Differential Serves All Mailers

The drop entry discounts for Standard (A) mail were introduced in R90-1. There is no question that this worksharing undertaking has been a resounding success. Both in absolute and comparative terms, the volume of mail that is drop entered has increased from year-to-year and certainly from rate case to rate case.

The drop entry incentives have worked in all dimensions. Obviously, there is a benefit to the very substantial number of mailers who drop enter, in the form of reduced postage costs. There are other, non-monetary benefits to these mailers as well. For example, precisely because mail trucked by a mailer to a destination BMC or SCF avoids intermediate stops and processing steps in the postal system, mail that is drop entered tends to arrive at its ultimate addressee destination in better condition than non-drop entered mail. This consideration is particularly important for catalog mailers. Also, drop entry enables mailers to compress the lag time between production of the mailing and its delivery and this favorably affects the total cost of the job. Drop entry mailers are not, however, the only beneficiaries of this worksharing arrangement. Hundreds of millions, if not billions, of dollars have been saved by the Postal Service since drop entry of Standard (A) mail was first introduced.

Experience also confirms that the deeper mail is entered into the postal system, the greater the monetary and non-monetary benefits to both the mailer and the postal system. For this reason, it makes sense to encourage mailers, through appropriate discounts, to drop enter at destination SCFs to the maximum extent possible. Put another way, in developing rates, the Postal Service and the Commission should, to the maximum extent possible, maintain a BMC/SCF differential that makes it worthwhile for mailers who have the choice to absorb the additional cost of transporting their mail and entering it at destination SCFs.

These considerations have not been taken into account by the Postal Service in developing its drop entry rates in this case. The decision to narrow the differential from .5 to .3 cents does not appear to have been dictated by cost or operational considerations. Nor does the differential reflect Postal Service marketing objectives. It is true that the drop entry discount proposed by the Postal Service for BMC entered mail provides a greater incentive than exists under current rates for mailers who do not now drop enter at all to begin to enter their mail at destination BMCs. At current rates, the BMC entry discount is 1.3 cents and the Postal Service has proposed to deepen that discount to 1.5 cents. But preservation of an appropriate BMC/SCF differential is not in conflict with the creation of a discount structure that also encourages greater BMC drop entry. The proposal advanced by AMMA preserves, and even strengthens, the incentive for mailers who do not now drop enter to begin to do so. At the same time it restores the BMC/SCF differential to level which closely approximate the current differential.

Conclusion

For these reasons, readjustment of the BMC and SCF discount rates in Standard (A) mail to preserve, as closely as possible, the existing BMC/SCF differential will serve the interests not only of affected mailers but of the postal system as a whole. The testimony of AMMA's economic consultant shows how this recalculation can be accomplished on a revenue neutral basis. There are those in the industry that believe paramount consideration should be given to the differential and there are other methods of readjustment that would, indeed, increase the differential above current levels. At the very least, the readjustment advanced by AMMA should be adopted.